

DROP Fact Sheet

Summary

The Deferred Retirement Option Program (DROP) is a means of providing employees who choose to work beyond their normal retirement date the flexibility to elect to receive some of their retirement benefits in a lump sum, rather than continuing to earn additional years of retirement service and higher monthly annuities.

Details

Specifically, DROP provides employees who are fully eligible for normal retirement the option to retire for purposes of the pension plan, while continuing to work and receive a salary for a period of up to three (3) years. During the DROP period, the pension plan accumulates the monthly retirement benefits in an account balance identified as payable to the member only at the end of the DROP period. The account balance is credited with 5% interest per annum, compounded monthly. At the end of the DROP period, the member terminates employment with the County and begins to receive his/her retirement benefit directly instead of having it credited as an increase to the DROP account balance. The retiree also receives the balance of his/her DROP account and may either: 1) accept a lump sum distribution; 2) authorize a rollover to another qualified plan; 3) elect to have his/her monthly retirement annuity increased by the actuarial equivalent of the lump sum, thereby receiving a higher lifetime monthly benefit; or 4) certain combinations of the above.

During the DROP period, members continue to receive all other active employee benefits. For example, members continue to accrue annual and sick leave and continue to be eligible for health, dental and life insurance at the same premium rates as other County employees.

History

DROP was first implemented for the Police Officers and Uniformed Retirement Systems effective October 2003. The program was adopted in response to employee interest in added benefit flexibility and management's recognition that DROP would assist in workforce planning, given that it both encouraged employees to stay beyond their normal retirement date and provided a more definitive date of retirement for planning purposes. Following the successful implementation of DROP for the public safety systems, a DROP provision was added to the Employees' Retirement System effective July 2005.

Impact

The consulting actuary to the three County retirement systems, Cheiron, has analyzed the impact that DROP has had on the systems' retirement patterns, and in a letter dated July 15, 2010, stated that "...statistics would imply that a major impact of the DROP has been for members to

substitute DROP for retirement.” The Department of Human Resources conducted a short survey of departments in 2008 to gauge the effectiveness of DROP from a senior management perspective and found that “Overall, managers provided positive feedback on their experience with the DROP program and indicated strong support for continuing the program.” “Knowledge transfer” and “succession planning” were recognized by department heads as primary values of the program.

Cost

The employer cost of DROP is difficult to determine. On one hand, the accrued monthly benefit that accumulates in a DROP account is exactly the same as the monthly annuity that would have been paid had the member simply retired. In addition, the employer ceases making retirement contributions on behalf of members during their DROP period. On the other hand, a retirement system benefits financially from having members continue to work as long as possible. (This may seem counterintuitive, because the members continue to earn service credit that increases the annuity ultimately received.) Thus, to the extent that a member enters DROP earlier than s/he otherwise would have retired, the system experiences a “liability loss”. The systems’ actuary has recently opined that it is “impossible to tell the actual cost of DROP without surveying each member who took the DROP to find out what they would have done had it not been offered”. Even the thoughtful responses to such a survey might not accurately reflect what actual behavior would have been. Senior County management has concluded that DROP-related employer costs are justified by the program benefits.

Example

A 55-year-old member of the Employees’ Retirement System (Plan A) with 25 years of service and a final average salary of \$65,000 enters DROP. Assuming that s/he does not select a survivor benefit, the initial amount of the monthly accrual into the DROP balance (including the pre-Social Security benefit) would be \$3,905.42. While in DROP, the member continues to receive a salary and an accrual is posted to his/her DROP balance on a monthly basis.

Assuming an average annual cost of living adjustment of 3%, and including 5% interest per annum, the total DROP balance at the end of three years would be \$143,917.67.

Upon exiting DROP, the member terminates employment; receives his/her DROP balance as a lump sum payment; and begins receiving a monthly retirement benefit of \$4,058.32.

This example is for illustration only; it does not take into consideration such factors as tax withholdings, joint and last survivor adjustment, and the retiree cost of health insurance.

Future of DROP

DROP was initially implemented in Fairfax County with a Sunset Provision. The Sunset Provision was removed from the DROP in October of 2010. There is currently no end date to the provisions of the DROP in Fairfax County.